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IN THE

Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,
Respondents.

ENERNOC, INC. *et al.*,
Petitioners,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

REPLY BRIEF OF PRIVATE PETITIONERS

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INTRODUCTION

We agree with EPSA that this case is not "complicated." EPSA Br. 1. The Federal Power Act ("FPA") grants FERC jurisdiction to regulate not only "the sale of electric energy at wholesale in interstate commerce," but also all "practice[s] ... affecting" wholesale rates. 16 U.S.C. §§824(b)(1), 824e(a). Order 745 addresses the terms on which demand response ("DR") providers participate in purely wholesale energy markets; that participation directly and significantly affects wholesale rates, and thus is clearly within FERC's jurisdiction. Under the FPA, states have plenary jurisdiction over "any other sale" of electricity, *i.e.*, retail sales. *Id.* §824(b)(1). DR participation is not a sale of electricity; it is a service indirectly affecting retail rates; and payments for DR participation in *wholesale markets* do not set any retail rate or mandate or prohibit any retail sale. Thus, Order 745 does not impinge on the states' reserved FPA jurisdiction. At bottom, EPSA is arguing that the FPA authorizes states *exclusively* to regulate not only retail rates and sales, but also "practice[s] ... affecting" retail sales. Both the statutory text and this Court's cases demonstrate that EPSA is wrong. All doubts are dispelled by the judicial deference owed to FERC's established position that DR participation in wholesale markets is a "practice ... affecting" wholesale rates.

This Court should also defer to FERC's reasonable exercise of that jurisdiction to set rates for DR participating in wholesale energy markets. FERC found an increase in DR compensation was required in light of substantial marketplace evidence demonstrating that economic barriers were impeding DR participation in such markets. FERC further explained that DR provides the same economic value as generation when

balancing the system, and thus fundamental principles of nondiscrimination required that both resources be compensated on the same basis. FERC's compensation standard ensures the efficient dispatch of DR and more competitive wholesale energy markets.

EPSA's contrary arguments lack merit.

ARGUMENT

I. ORDER 745 REGULATES A PRACTICE DIRECTLY AFFECTING WHOLESALE RATES.

In neither purpose nor substance is Order 745 a regulation of retail rates.

A. EPSA's Arguments All Flow From Two Incorrect Premises.

1. EPSA claims (Br. 35) that the FERC's "whole point" in promulgating Order 745 was "to affect the quantity, timing and pricing of retail sales." And, EPSA asserts (roughly 25 times) that FERC impermissibly regulates retail sales, because it increases the "*effective*" price or rate of retail sales to customers who reduce their retail purchases. *E.g.*, *id.* at 1 (emphasis added). Both assertions are wrong.

First, in regulating DR, FERC's purpose has never been to regulate retail rates, but instead to achieve the goal Congress mandated: that wholesale rates for electricity be "just and reasonable," and not "unduly discriminatory." 16 U.S.C. §§824d(a), (b); 824e(a). FERC has repeatedly explained that its purpose in regulating DR participation in wholesale markets is to "[i]mprov[e] the competitiveness of organized wholesale markets" in order to "fulfil[l] its statutory mandate to ensure supplies of electric energy at just,

reasonable and not unduly discriminatory or preferential rates." Order 719 ¶1; see also *id.* ¶12; Order 745-A ¶11 (same) (App.52a); *id.* ¶28 (same) (App.64a-65a). In addition, FERC viewed DR as an important resource to increase "system reliability and address ... resource management challenges surrounding the unexpected loss of generation." Order 745 ¶10 (App.147a). EPSA flatly misstates FERC's purposes.

Second, Order 745 does not in any way set the "retail" price for electricity, and payments for DR participation in wholesale markets do not "*raise*" retail rates. *E.g.*, EPSA Br. 10, 22, 54 (emphasis added). Under the FPA, and contrary to EPSA (Br. 27), there is a material and legally significant difference between directly setting a rate and engaging in regulation that may ultimately affect a customer's retail rate or its "effective" retail rate. See Private Pets. Br. 32-33, 35-38. EPSA's argument ignores that distinction *and* fails to do business with this Court's cases that rely on it. See, *e.g.*, *Fed. Power Comm'n v. La. Power & Light Co.*, 406 U.S. 621, 637-38 (1972) ("The answer is that ... §1(b) withheld from [FERC] only *rate-setting* authority with respect to direct sales."). Indeed, EPSA's argument that Order 745 alters "*effective*" retail rates is fatal to its case in light of the FPA's text and this Court's decisions holding that only federal regulation that actually "*set[s]*" retail rates impinges on state jurisdiction. See Private Pets. Br. 31-32, 35-38. In addition, EPSA's argument ignores that sales of DR service are not "sale[s] of electric energy," and thus are not within the states' exclusive jurisdiction under the FPA. See *id.* at 31 n.4.

Putting these dispositive legal points aside, EPSA's chain of reasoning is that a retail customer who can bid a reduction in demand into the wholesale market has a higher overall effective cost of electric energy,

because that customer pays the retail rate for the electric energy consumed *and* gives up compensation for reducing consumption. This scenario ignores many critical points: Many retail customers are not qualified to directly bid DR into wholesale markets; there are numerous requirements and certifications with attendant costs in order to do so. See, *e.g.*, Order 745 ¶¶93-95 (App.206a-208a) (measurement and verification requirements); Private Pets. Br. 43-47.[1] In addition, DR payments occur in the wholesale energy market only when there is a "net benefit[]" obtained from reducing demand. Order 745 ¶¶48, 53 (App.177a, 179a-180a). Moreover, customers who forgo consumption and obtain a DR payment often shift their consumption to a different time when energy is less expensive. Private Pets. Br. 54. For such customers, the potential DR payment would not *increase* the effective retail rate for consumption; it compensates for time-shifting and, if anything, *lowers* the overall "effective" cost of energy.

Leaving these points aside, a retail customer's decision to reduce consumption of electricity when a wholesale market operator is dispatching DR resources may initiate a chain of events that affect the consumer's "effective" cost of electricity. For example, that customer's reduction may be combined with nu-

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[1] EPSA mocks (Br. 35) the technology necessary for DR participation in wholesale markets; but sarcasm is not an argument. DR can participate in wholesale markets only if the commitment to reduce consumption is firm and promptly dispatchable to meet system balancing requirements and forestall the market operator's need to access more expensive resources. This capability requires significant investments, as well as satisfaction of numerous other requirements contained in the market operator's tariffs. *See* Private Pets. Br. 43-47.

merous others offered by an aggregator, which provides a firm commitment to reduce consumption when called by the interstate system operator, resulting in (i) a DR payment from the aggregator to the retail customer *and* (ii) lower wholesale rates, which may lead to lower retail rates for the retail customer. In contrast, if the retail customer were to decide to consume electricity when the wholesale market operator is purchasing DR resources, that customer would forgo a DR payment, but eventually enjoy lower retail rates resulting from the reduction in wholesale rates arising from other customers' DR commitments. Put differently, DR participation in wholesale markets and the potential for a DR payment for reducing consumption may, respectively, lower and raise the customer's overall effective cost of electricity. So, too, many other factors, such as the ability to shift production—and thus energy use—to a different time will alter a customer's effective cost. None of this turns FERC's regulation of DR participation in wholesale markets into the setting of a retail rate or the regulation of a retail sale under the FPA.

2. EPSA's variations on its theme lack merit. For example, EPSA argues that Order 745 "lure[s]" *retail* customers into wholesale markets. Br. 30-31. Initially, this argument is not historically accurate. DR first participated in wholesale markets over a decade ago through market operator tariffs to address shortfalls and emergencies. Private Pets. Br. 11.

Most significantly, however, this argument incorrectly assumes that a retail customer's reduction in consumption is a sale of electricity, and therefore that offering a firm commitment to reduce demand in wholesale markets is a "retail sale." As previously explained, a sale of DR is not a sale of electricity, and thus not within the states' exclusive jurisdiction. Pri-

vate Pets. Br. 31-32. Instead, a firm commitment to reduce demand when called upon is a service that can be sold to either wholesale or retail market operators.

Contrary to EPSA's amici PUCs (Br. 10), no entity is inherently and always a "retail custome[r]" of electricity; the appropriate label turns on the entity's activity. When purchasing energy for consumption, a business is a retail electricity customer. When purchasing or selling energy in a wholesale market for resale, a business is a wholesale buyer or seller. When making a firm commitment to reduce demand when called upon by a wholesale market operator, a business is a wholesale DR resource provider. The beneficial consequence—that DR participation in wholesale markets lowers the locational marginal price ("LMP"), *i.e.*, the wholesale rate, which ultimately results in lower retail rates—does not mean that an entity offering DR in wholesale markets for electricity is participating as a retail customer, much less "solely in [that] capacity." EPSA Br. 30. Similarly, the fact that a customer receives payment for providing DR—which *may* affect the customer's consumption level (or shift the time of consumption) and "effective" electricity costs—does not convert a firm commitment to reduce consumption when called upon by a wholesale market operator into a retail sale of electricity.

In a similar vein, EPSA contends that FERC cannot rely on the FPA's grant of "affecting" jurisdiction to regulate retail rates and sales. *E.g.*, *id.* at 33 ("FERC cannot lay claim to retail regulation on the ground that excessive retail demand is affecting wholesale rates"). But FERC is not "claiming" retail regulation; it is regulating a "practice ... affecting" wholesale markets in a way that may ultimately affect retail rates, as the FPA and this Court's cases authorize.

EPSA also argues (Br. 34) that if FERC's regulation of DR participation in wholesale markets is within its "affecting" jurisdiction, that jurisdiction has no limiting principle. EPSA ignores longstanding precedent that limits FERC's regulatory authority to practices "that *directly* affect the rate or are closely related to the rate." *Cal. Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 396, 403 (D.C. Cir. 2004) (emphasis added). EPSA claims coal and steel sellers are equivalent to retail electricity customers (lured improperly into wholesale markets) and argues that FERC can regulate neither. But the relationship between inputs (such as coal and steel) and wholesale prices is indirect, while DR participation in wholesale markets directly *changes* wholesale rates under Order 745. Private Pet. Br. 32-34. This case does not present a difficult question whether a practice has a direct or indirect effect on wholesale rates.

Further, EPSA suggests (Br. 42) that "this case does not have any ambiguity as to which *Chevron* is relevant," because there is "no ambiguity about the nature of the problem or the customers to which FERC's 'demand response' initiative is addressed." But *Chevron* is "relevant" to *statutory* ambiguity, not any ambiguity related to an issue; and the question is whether DR participation in wholesale markets is a "practice ... affecting" wholesale rates. FERC's conclusion warrants deference, particularly since FERC's position has been consistent for over a decade. *Barnhart v. Walton*, 535 U.S. 212, 219-20 (2002).

EPSA adds, without citation, that FERC is not entitled to deference in interpreting the scope of the FPA's reservation of authority to the states. Br. 43. But this Court has already interpreted that statutory reservation as FERC did. See Private Pets. Br. 32-33, 35-38. Moreover, *City of Arlington v. FCC* makes

clear that agency interpretations of statutory jurisdictional grants are entitled to deference, including those involving "'matters of traditional state and local concern.'" 133 S. Ct. 1863, 1868, 1873-75 (2013); see also *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 379 n.6 (1999).[2]

B. Order 745 Does Not "Supplant" State Decisions About Retail Rates And Sales.

EPSA claims (Br. 29) that Order 745 is an "avowed effort to override state electricity policy choices" and "reset the effective price for retail electricity sales." EPSA does not believe that Order 745 actually changes retail rates or prevents any state from adopting a stable pricing regime.[3] Instead, EPSA objects to the indirect effect of FERC regulation of wholesale markets on retail consumers' "effective" electricity costs. But, as explained above, the FPA gives FERC jurisdiction over wholesale markets and practices affecting them to ensure just and reasonable rates *even if FERC's regulation ultimately affects retail rates.*

While EPSA waves the federalism flag throughout its brief, it fails to mention until page 40 that FERC's

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[2] EPSA denigrates Congress's instruction in the Energy Policy Act of 2005 that "unnecessary barriers to demand response participation in energy, capacity and ancillary services markets shall be eliminated," claiming without evidence that Congress was referring only to barriers to "*retail-level* demand response." Br. 44-45. No such limit appears in §1252(f), and the three markets mentioned are the "familiar triad" of wholesale markets. *See* Environmental Organizations Br. 23.

[3] EPSA suggests (Br. 42 n.6) that some states favor Order 745 because it allows them to give consumers stable rates, while obtaining the benefits of real-time pricing, *i.e.*, to "obscur[e] ... accountability." EPSA never explains why state officials would seek to obscure accountability for lower, stable retail rates.

regulation expressly allows states to decide whether their citizens may offer DR resources in wholesale markets. See Private Pets. Br. 16. Order 745 presents no federalism issue; it is an illustration of cooperative federalism.

EPSA's specific responses to petitioners' demonstration that Order 745 does not impinge on state authority are without merit.

1. As previously noted, DR involves a commitment not to consume electricity which does not involve a sale at all, App.32a (Edwards, J., dissenting), and thus does not impinge on the states' jurisdiction over retail sales. EPSA claims (Br. 35) this contention is "misleading" because the "whole point" of Order 745 is "to affect the quantity, timing and pricing of retail sales." As shown above (pp. 2-3), however, that was not the Order's purpose or effect.

EPSA also contends that the argument that DR is not a "sale" is "legally irrelevant" because it assumes that state authority is confined "to the artificially narrow subject of fully consummated [retail] sales." Br. 36. But EPSA's contention is, in essence, that the FPA authorizes states *exclusively* to regulate not only retail rates and sales, but also "practice[s] ... affecting" retail sales. EPSA cites no supporting statutory text or case, and fails to distinguish this Court's contrary cases. See Private Pets. Br. 35-38 (citing, *inter alia*, *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986); *Federal Power Comm'n v. La. Power & Light Co.*, 406 U.S. 621, 623, 637-38, 642 (1972)). Cf. *ONEOK, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591 (2015) (assuming FERC's jurisdiction over practices affecting wholesale and retail rates).

Ironically, EPSA cites *FERC's* broader authority over wholesale rates, and claims that "the States' re-

served plenary authority over the retail market ... cannot be narrower" than that federal authority. Br. 37, 39. But that is EPSA's fundamental error. FERC's authority over "practices ... affecting" wholesale rates and over "all rates and charges ... for or in connection with" wholesale sales is dispositive here. The states have no comparable exclusive expanded authority with respect to retail rates and sales. See *N. Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 92-93 (1963); *Miss. Power & Light Co. v. Miss. ex rel. Moore*, 487 U.S. 354, 371 (1988).

2. EPSA argues that allowing states to prohibit their citizens from participating in DR offerings in wholesale markets does not adequately protect state jurisdiction. EPSA notes that where FERC has jurisdiction, "it does not (and could not) authorize States to opt out and ... override its deliberate policy choices." Br. 40. Under this Court's decision in *ONEOK*, 135 S. Ct. at 1599, the proper analysis of the FPA's preemptive effect on state laws is conflict, rather than field, preemption. If state laws or regulations are expressly authorized by federal regulation, there is no conflict. Here, FERC reasonably determined that its approach of cooperative federalism would result in just and reasonable wholesale rates.

EPSA also contends (Br. 41) that requiring states to "enac[t] an additional affirmative law" to preclude citizens from participating in wholesale markets imposes too great a burden on states, constraining "the autonomy of retail customers." But contrary to EPSA, which complains (Br. 41-42) about "the difficulty of passing any legislation," state regulatory commissions can opt out by regulatory action. 18 C.F.R. §35.28(g)(1)(i)(A). See also EPSA-Amici State Br. 29-31 (describing regulatory partial opt-outs). And it is EPSA's view that sacrifices state citizens' "autono-

my," by precluding them from offering DR into wholesale markets under tariffs whose terms FERC must approve. See FERC Br. 31-32.

EPSA also argues that denying FERC jurisdiction to regulate DR participation in wholesale markets will not create a "regulatory gap." Br. 45. But EPSA responds to FERC's argument that "if it cannot regulate the price of 'demand response' payments in the wholesale markets, then no one can," by saying "[t]hat may well be true." *Id.* at 46. EPSA's solution? Have "state and local retail regulators" implement "their own demand response schemes." *Id.* at 46-47. See also EPSA-Amici State Br. 25-31. This fails to answer FERC's point that states *cannot* regulate DR participation within wholesale markets or FERC's extensive findings that existing state retail DR programs have not delivered the lower wholesale rates, increased system reliability and competitive benefits of wholesale DR participation. FERC Br. 31-33; Private Pets. Br. 16-17, 38-40.

EPSA's further proposal—"FERC paying *wholesale* purchasers who reduce their wholesale purchases" (Br. 47)—makes no sense; FERC is not a market participant. If EPSA meant that market operators should pay wholesale purchasers to reduce wholesale purchases when demand peaks or in a system emergency, its solution is flawed. At best, some benefits of DR may trickle into wholesale markets. FERC found such levels of DR participation inadequate. See Private Pets. Br. 42-47. And public utilities and power suppliers, whose business is selling electricity, do not have appropriate incentives to procure or promote DR. See Electricity Consumers Br. 11-15 (explaining financial disincentives for adequate DR participation in wholesale markets through retail programs); NRG Br. 21-22 (explaining limits on retail DR programs).

Moreover, EPSA's emphasis on FERC's authority to regulate DR participation by wholesale purchasers effectively recognizes that *any* DR participation in wholesale markets is a "practice[e] affecting" wholesale rates within FERC's jurisdiction. There is nothing in the phrase "practices ... affecting" wholesale rates that distinguishes among those engaged in the relevant practice.

Similarly, EPSA's state amici—uninterested in participating in FERC's rulemaking, at the D.C. Circuit or on petition here—now oppose FERC's jurisdiction. Like EPSA, the newly-interested state amici argue that inadequate DR participation in wholesale markets would not be problematic because retail DR programs can pick up some of the slack. EPSA-Amici States Br. 14, 28-30; EPSA-Amici PUCs Br. 13. As noted, based on the administrative record, FERC found then-existing levels of DR participation in wholesale markets insufficient to ensure just and reasonable wholesale rates and provide the reliability benefits that DR offers. Those findings cannot be overcome by amici's assertions that retail DR programs provide some benefits.[4]

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[4] EPSA's amici PUCs also cite PJM's "new construct for demand response participation" as diminishing the damage from loss of DR participation in wholesale markets. Br. 15. EPSA opposed that package as "seriously flawed," Comments, 5-6, Docket ER15-852-000 (Feb. 13, 2105), *available at* https://www.epsa.org/forms/uploadFiles/2ED340000000E.filename.ER15-852_EPSA_Comments.pdf, and PJM called it a "stop-gap" that "would be superior to rules that do not recognize any demand response," *i.e.*, better than nothing. PJM Interconn., L.L.C., *Revisions to the Reliability Pricing Market*, 2-3, Docket ER15-852-00 (Jan. 14, 2015), *available at* http://www.pjm.com/media/documents/etariff/FercDockets/1402/2015114-er15-852-000-Stop-Gap%20Filing.pdf.

II. EPSA'S ATTACKS ON FERC'S COMPENSATION STANDARD FOR DR ARE MERITLESS.

As petitioners demonstrated, "[t]he central insight of the Rule ... is that in organized wholesale energy markets a commitment to reduce demand is identical, for economic purposes, to additional supply that could satisfy the same amount of demand," and therefore that DR and generation resources should be paid on an equivalent basis when balancing the system. FERC Br. 52; Private Pets. Br. 52-53. EPSA does not—and cannot—dispute this "principle of symmetry" on the merits. FERC Br. 54. Instead, EPSA asserts that Order 745's approach to compensation for DR is an arbitrary and unexplained departure from precedent. Alternatively, EPSA contends that Order 745's compensation standard will deter efficient production and result in inefficient amounts of DR participation. The first assertion is incorrect. The second one is not only wrong, but also challenges matters that are clearly within FERC's discretion to decide.

A. FERC Explained Its Revised Compensation Approach.

EPSA asserts (Br. 50-52, 55-56) that FERC's requirement that wholesale market operators pay DR providers the same compensation as generators when they provide equivalent value reversed FERC's prior policy without explanation. This argument ignores

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EPSA's amici states also claim the opt-out will not work because customers may bid DR into wholesale markets in violation of state regulations. Br. 32. This argument raises questions of enforcement, but does not militate against FERC jurisdiction.

FERC's historic treatment of DR compensation and FERC's explanation of Order 745's basis, in both its Notice of Proposed Rulemaking ("NOPR") and its Order.

First, even prior to Order 745, FERC had "required RTOs and ISOs to ... accept bids from demand response resources in their markets for certain ancillary services on a basis comparable to other resources," Order 745 ¶12 (citing Order 719 ¶¶47-49) (App.149a), and approved tariffs filed by system operators that allowed DR "to participate directly in the day-ahead and real time energy markets, certain ancillary service markets and capacity markets," *id.* ¶13 (App.149a). Notably—contrary to EPSA's assertions—FERC had repeatedly approved tariffs that compensated DR services *at LMP* in certain circumstances. *Id.* ¶14 (App.150a-52a); NOPR ¶8 (JA30-32).

In addition, in Order 745, FERC determined that compensating DR services "at the market price for energy, referred to as [LMP] .... is necessary to ensure that rates are just and reasonable in the organized wholesale energy markets." Order 745 ¶2 (App.141a-42a). In findings that EPSA ignores, FERC explained how participation of DR in wholesale markets can lower wholesale prices. Order 745-A ¶67 ("Demand response resource participation helps to balance supply and demand, helping to produce just and reasonable energy prices by lowering the amount of higher-cost generation dispatched to satisfy system demand.") (App.88a); see *id.* ¶23 (App.58a-59a). FERC further found that payment of LMP was necessary to overcome "barriers to entry" to full participation of DR resources in wholesale energy markets. *Id.* ¶¶58-63 (App.81a-86a). Because of the costs associated with providing DR in wholesale markets, compensating DR resources at LMP-G would result in whole-

sale rates "higher than [they] would be in a competitive market." *Id.* ¶59 (App.83a).

To be sure, prior to Order 745, FERC had allowed one system operator (PJM) to stop paying LMP for DR services and to pay LMP-G instead. See EPSA Br. 55-56. But even there, FERC recognized that compensation greater than LMP-G could be necessary to "produce just and reasonable rates." *PJM Indus. Customer Coal. v. PJM Interconn. L.L.C.*, 121 FERC ¶61,315, ¶29 (2007). And, as noted above, FERC permitted system operators to pay LMP in other circumstances.

Thus, FERC did not, as EPSA suggests (Br. 50, 56), have an unbending "policy" that system operators may only pay LMP-G for DR resources. And, putting this fact aside, agencies are permitted to change course. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 517-18 (2009). Here, FERC explained in detail why it was mandating that system operators compensate DR services at the same level as generation—*i.e.*, LMP. *Supra* p. 14; Private Pets. Br. 42-50; FERC Br. 47-52.

Contrary to EPSA (Br. 55-56), far from ducking its prior order, FERC expressly acknowledged it at the outset of this proceeding. See NOPR ¶21 n.48 (citing and discussing *PJM Interconnection, L.L.C.*, 121 FERC ¶61,315 (2007) (JA42)); Private Pets. Br. 42; FERC Br. 56-57. FERC frankly stated that it had previously "rejected a complaint that PJM's existing compensation for [DR services] (LMP minus the generation and transmission components of the retail rate) was unjust and unreasonable." NOPR ¶21 n.48

(JA42).[5] But FERC explained, subsequent events called that decision into question. *Id.* In particular, FERC emphasized that DR participation in PJM markets declined substantially after it allowed PJM to decrease compensation for DR services. *Id.* ¶10 (JA33-34). Thus, FERC specifically *instituted* this proceeding to reconsider the conclusions of the very order EPSA claims FERC has ignored.

FERC confronted its prior precedent and explained why it decided to require DR services to be compensated at LMP instead of LMP-G. Indeed, in light of the relevant marketplace evidence it received after its order in *PJM Interconnection*, it would have been arbitrary for FERC to refuse to reexamine DR compensation standards. *Cf. Bechtel v. FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992) (agency has a "duty to evaluate its policies over time to ascertain whether they work [as the agency] originally predicted" and account for "changes in factual and legal circumstances").

B. Paying LMP Will Not Deter Efficient Production; It Will Induce Efficient DR Participation.

1. EPSA incorrectly contends that compensating DR services on par with generation services will induce businesses offering DR to forgo "productive economic activity." Br. 52; see also *id.* at 51, 53, 56, 58. In EPSA's view, under FERC's compensation standard, demand responders will not only earn LMP, but also retain the "savings retail customers achieve by not purchasing electricity." *Id.* at 3. But as we and the United States explained, that is wrong. A DR

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[5] FERC also acknowledged in the NOPR (and Order 745) that it had previously allowed PJM to compensate DR at LMP-G. Order 745 ¶14 (App.150a); NOPR ¶8 (JA30-32).

provider "incurs costs when it refrains from taking power from the grid." FERC Br. 53-54. Foremost, DR resources can participate in wholesale bidding markets only after making substantial investments in specialized equipment and technologies. Private Pets. Br. 43; FERC Br. 54. Further, in many instances, a demand responder will not save the cost of electricity because it will merely *shift* the time it uses electricity to a point when demand is lower. Private Pets. Br. 54-55. Finally, businesses providing DR frequently incur shut down and start up costs when ceasing production. *Id.* at 55.[6]

EPSA concedes (Br. 53 n.8) that many DR providers shift the time of use of electricity (and thus ultimately pay "G" when they consume the electricity at a later time). But EPSA asserts that such a DR provider will nonetheless save some money when subsequently buying electricity when it is cheaper. This response is a *non-sequitur*. The scenario EPSA describes underscores that DR can *increase* economic efficiency, because the business will produce the same goods and services that it would have produced absent DR participation, but at a *lower* cost. Further, society benefits because the sale of DR by the business *lowers* wholesale electricity rates.

Given the costs incurred in providing DR services, EPSA is forced to concede that LMP-G may not be sufficiently compensatory. Br. 57 n.9 (acknowledging that LMP-G may result in an "effective rate ... less

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[6] Moreover, EPSA's complaint that payment for DR may curtail efficient "productive economic activity" is not even a theoretical concern with regard to DR participation that reduces consumption in ways that are "entirely intangible, such as students sitting in classrooms that are 1 degree warmer." Electricity Consumers Br. 27.

than LMP" and thus may need a "positive adjustment"). EPSA vaguely suggests that FERC should be required to determine the appropriate "positive adjustment" to LMP-G in connection with every DR transaction because payment of "full LMP is far too blunt a tool" to address the problem. *Id.*

These are exactly the types of technical ratemaking decisions to which FERC is owed maximum deference. *Morgan Stanley Capital Grp., Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 532 (2008). To determine "LMP-(G+X)" in connection with every DR transaction, FERC would need to measure the portion of the retail rate that DR participation would "save," ("G"), then add the costs of providing DR (including payments to DR aggregators, costs of shifting production to a different time, start up/shut down costs, etc.) ("X"), and then subtract the sum of G plus X from LMP to determine the DR payment. The "logic" of EPSA's position would also require FERC to reassess the payment structure for generators by subtracting the generators' costs from their LMP payments. See Private Pets. Br. 53; FERC Br. 54.

As explained (Private Pets. Br. 55), this is not workable, and EPSA makes no attempt to refute that showing. Nor is it necessary. EPSA recognizes that FERC may reasonably require compensation in excess of LMP-G to "jump-start" DR participation in wholesale markets. Br. 17 n.1. And, FERC's findings here support the need for at least a "jump-start." As FERC explained, in seeking to fulfill its mandate to ensure just and reasonable rates and competitive wholesale markets, its "policy has been, and continues to be, to identify and eliminate barriers to participation of [DR] resources in organized power markets." Order 719 ¶48. And in Order 745, FERC found that there are substantial costs to providing DR ser-

vices, that participation of DR in wholesale markets had declined when payments were lowered to LMP-G, and that DR participation generally has been inhibited by barriers to entry. Private Pets. Br. 43-47 (discussing FERC's findings); FERC Br. 51-52 (same).

At the same time, rather than using a "blunt tool," FERC carefully circumscribed when LMP should be paid. FERC did not mandate LMP "in all hours," Order 745 ¶94 (App.207a), but required its payment only when DR services (i) "balance supply and demand as an alternative to a generation resource" and (ii) "dispatch of that [DR] resource is cost-effective." *Id.* ¶2 (App.141a-142a).

2. EPSA's amici economists seek to shore up EPSA's critique of LMP, but their arguments are equally flawed. They repeatedly argue that FERC is "subsidiz[ing]" DR based on their assumption that FERC has given "demand-responders one critical input for free." Br. 15; see also *id.* 11-12, 26. But FERC is no more giving DR providers a free input than it is giving solar power generators free sun. It is state law, not FERC, that provides retail customers with a "property right to consume energy at [a] fixed tariff price." JA10191. Further, DR resources are not "sell[ing] electricity they do not own," Borlick Br. 15, but are instead selling an enforceable commitment to relinquish a "property right" to buy electricity. That commitment is of enormous value to a system operator and, ultimately, to all consumers of electricity. See PJM Br. 13. And, as explained above and in our opening brief (pp. 43-47), substantial costs are incurred in deploying the infrastructure necessary to allow that commitment to be bid into dynamic wholesale energy markets and in providing DR service when dispatched by system operators.

Advancing a series of stylized hypotheticals, EPSA's amici economists claim that FERC's compensation scheme deters efficient production. Amici's hypotheticals, however, ignore that DR can increase efficiency by lowering prices for all wholesale purchasers and increase system reliability. See Br. 16-17 & n.3 (conceding numerical examples ignore that DR can reduce LMP). Moreover, like EPSA itself, these amici also counterfactually assume that DR providers retain *all* savings associated with avoided retail costs (and thus are effectively paid LMP+G). But see *supra* pp. 16-17. Indeed, as explained above, in many cases DR participation will *increase* efficiency by shifting production to a later time when the social costs of production are lower. While EPSA's amici economists dismissively assert (Br. 17) this is "changing the subject," they never really address our argument.[7]

EPSA's amici are, however, right about one point: FERC should strive to enact policies that benefit the public generally and not a particular industry segment. Br. 29, 34. FERC sought to do that by compensating all market participants at the same level *when providing comparable services*. Private Pets. Br. 48

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[7] EPSA's amici economists also assert (Br. 18-20, 24) that some DR resources will self-supply power and offer DR resources when they have merely shifted to "behind-the-meter" generation. *See also* NRG Br. 25-28. EPSA, however, did not press this argument before the D.C. Circuit, and the lower court did not address it. The issue is therefore not before this Court. *FTC v. Phoebe Putney Health Sys., Inc.*, 133 S. Ct. 1003, 1010-11 n.4 (2013). In all events, Order 745 addressed this concern, explaining that concerns regarding "use and measurement of behind the meter generation to facilitate demand response" are appropriately addressed in "individual RTO and ISO compliance filings or separate section 205 or 206 filings." Order 745-A ¶66 (App.88a); *see also* Order 745 ¶¶94-95 (App.207a-208a).

(discussing FERC findings). Indeed, FERC permitted compensation of DR services at LMP only where it reduces wholesale rates by amounts greater than payments to the DR provider. Order 745 ¶53 (App.179a-180a).

In contrast, because providing DR services is costly, the discriminatory compensation scheme favored by amici economists (LMP-G) will result in a socially insufficient supply of DR services—a point *EPSA* acknowledges (Br. 57 n.9). Adopting LMP-G would cripple DR as an effective market participant and increase the dispatch of relatively inefficient, high-cost generation even when DR services could balance the system at a lower cost, as FERC and its supporting economists explain. EPSA's amici economists' myopic view of "total social welfare" favors only generators, which is not surprising. See Br. 2 n.1.

3. Finally, without citation, EPSA asserts that it is "fanciful" to say "reduction in retail demand is equivalent to increase in wholesale production." Br. 56.

Far from "fanciful," FERC's analysis was well-supported and reasonable. FERC specifically found, based on industry comments and expert testimony, that DR participation could be as effective in balancing the system as an increase in generation and provides the same economic value to system operators under the net benefits test. Order 745-A ¶¶56-58, 63-66 (App.79a-82a, App.84a-88a); Order 745 ¶¶55, 61 (App.181a, 185a).[8] In so finding, FERC did not simplistically assume that a "negawatt" of DR is the same as a "megawatt" of generation in all circumstances. Private Pets. Br. 50-51. To the contrary,

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[8] Indeed, DR can be more effective than generation in responding to emergencies. Electricity Consumers Br. 28 n.17.

FERC recognized that while DR services and generation may not be identical resources in all respects, "both types of resources are equally able to assist RTOs and ISOs in maintaining a balance between supply and demand when they meet an RTO's or ISO's requirements to deliver their product or service when and where needed *on the margin*," Order 745-A ¶57 (App.81a) (emphasis added)—a finding supported by leading experts in electric grid operations, see Grid Engineers Br. 17 ("[F]rom a grid operator's perspective, demand response resources and generation resources are comparable for purposes of balancing supply and demand in wholesale electricity markets over all time scales from cycles to hours."). And FERC carefully tailored its compensation scheme to be consistent with its findings, authorizing payment of LMP for DR services only in situations where, in fact, they are "comparabl[e]" to generation in allowing a wholesale market operator to balance the system. Order 745-A ¶57 (App.80a-81a).

CONCLUSION

For these reasons and those stated in our opening brief, the Court should reverse the decision of the court of appeals.

Respectfully submitted,

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